

Project Name	Korea-Corporate and (*)... Financial Sector Restructuring Loan
Region	East Asia and Pacific
Project ID	KRPE58594
Borrower(s)	Republic of Korea
Implementing Agency	World Bank 1818 H Street N.W. Washington, D.C. 20433 Telephone: (202) 458-5454 Fax: (202) 522-1500
Environment Category	C
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1. Country and Sector Background

Korea has made substantial progress in its post-crisis structural reform program. Thanks to this progress, and supported by responsive macroeconomic policies, an economic recovery is now under way. Following a drop of 5.8 percent in 1998, GDP in the first half of 1999 rose 7.3 percent year-on-year. Most analysts now project growth of around 8 percent in 1999. Market confidence has continued to improve as structural reforms have progressed (overall at a faster pace than in other crisis countries), reflected in upgrades in Korea's credit ratings and resumption of capital inflows. Much of the structural reform program has been supported by Bank structural adjustment loans (SALs) and complementary technical assistance.

While these developments are indeed gratifying, the sustainability of economic recovery is by no means assured yet. The crisis revealed deep structural problems in Korea's financial and corporate sectors which will take much longer to be resolved. Recognizing that Korea must address such root causes of the crisis in order to reduce vulnerabilities to future shocks and lay a foundation for future growth better attuned to the imperatives of global economic change, the Government's reform program, supported by the Bank, aims at a virtual paradigm shift in Korea's incentives and institutional framework--from state direction and opaque business nexuses toward a market-based economy with more transparent rules and governance. While progress on this reform program has been substantial, there is still much further to go, especially on corporate restructuring. Whether Korea succeeds in consolidating its economic recovery and restoring sustained growth will depend crucially on whether it perseveres with the implementation of the remaining reform agenda.

The Korean authorities have requested that the Bank continue to support their structural reform program through follow-up adjustment lending. They see continued Bank support as helpful in their efforts to maintain the momentum of their reform program, since a substantial agenda remains unfinished and Bank

structural adjustment lending would provide a continued disciplined framework for its implementation. Continued Bank support would also strengthen the Government's hand vis-a-vis domestic political constituencies in carrying the implementation of difficult reforms forward.

1. Objectives

A particularly high priority in the reform agenda for the period ahead is the implementation of corporate restructuring, especially the restructuring of the top five chaebols where progress so far has been slow. This is an area where the reform program faces perhaps the greatest risks to its sustainability. Effective corporate restructuring is essential to restoring financial viability and competitiveness of Korea's corporate sector (by reducing the debt overhang and facilitating operational restructuring conducive to enhanced profitability). It is also essential to durable restructuring and recapitalization of the financial sector. Accordingly, the proposed adjustment loan focuses on corporate restructuring and related restructuring of the financial sector.

Since the crisis, the Government has put in place a number of new laws and policies and institutional arrangements for the restructuring of the economy. With these actions, which were supported by World Bank SALs, much of the framework for structural reform is now in place. The future agenda is primarily one of deepening this reform framework and ensuring its effective implementation. The proposed loan, therefore, will focus on supporting the continued implementation of reforms commenced under the previous SALs. Moreover, given the progress already achieved on structural reforms within a comprehensive reform framework established by the previous SALs, the proposed operation will be much more selective in its scope and content, focusing on key aspects of corporate and financial sector restructuring.

2. Description

The corporate sector agenda for the proposed operation includes: (i) strengthening the institutional and policy framework for implementation of corporate debt and operational restructuring, covering both the top 5 chaebols and other chaebols and large corporations; and (ii) following through on improvements in corporate governance, financial transparency and accountability, and competition policies in order to expose chaebols and other corporations to greater market discipline and upgrade corporate culture.

In the financial sector, the proposed loan will support the continuation of government efforts to: (i) restructure and recapitalize the banking system, with special focus on strengthening linkages between corporate and financial sector restructuring (to enhance incentives for restructuring and ensure policy consistency), (ii) further strengthen prudential regulation and supervision, and (iii) restructure non-bank financial institutions (investment trust industry, insurance companies).

3. Financing

The proposed loan is a fast-disbursing, single-tranche, single currency loan of \$250-300 million.

4. Implementation

Korea has a strong track record of implementation of its undertakings with the Bank. Implementation of reforms supported by the structural adjustment loans made by the Bank since the crisis has been good overall. Given the single tranche design, the program supported by the proposed loan provides for a substantial agenda of actions and progress on implementation to be completed prior to Board presentation. Policy undertakings will be clearly spelled out in the Government's Letter of Development Policy and the Policy Matrix. The main implementation agencies will be the Ministry of Finance and Economy and the Financial Supervisory Commission.

5. Sustainability

As noted above, Korea has already achieved a strong and rapid recovery from the 1997 economic crisis. Translating this recovery into a return to robust and sustained growth will require further progress in dealing with the structural deficiencies in the corporate and financial sectors. The determination shown by the Korean Government in implementing difficult reforms at a relatively quick pace since the crisis augurs well for the sustainability of the reform effort. While difficult challenges remain in corporate and financial sector restructuring, a good foundation has been laid to build on. The Policy Matrix for the proposed loan will identify an agenda and progress benchmarks for continued implementation of reforms beyond the disbursement of the loan.

6. Lessons learned from past operations in the country/sector
Reducing corporate sector overindebtedness, establishing a more transparent and competitive business environment, and placing the financial system on a sound footing are essential to enhancing the Korean economy's resilience to shocks and restoring sustained growth.

7. Poverty Category
N.A.

8. Environmental Aspects
N.A.

9. Program Objective Categories
Structural reform.

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Note: This is information on an evolving project. Certain components may not be necessarily included in the final project.

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